

GUIDELINES:	OWN RISK AND SOLVENCY ASSESSMENT (ORSA) AND INTERNAL TARGET CAPITAL (ITC)
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DISTRIBUTION:	BC INCORPORATED INSURERS

PURPOSE

To inform all British Columbia incorporated insurance companies that the Financial Institutions Commission (FICOM) intends to adopt two guidelines recently published by the federal Office of the Superintendent of Financial Institutions (OSFI). The two guidelines are as follows:

- *Guideline E-19: Own Risk and Solvency Assessment (ORSA); and*
- *Guideline A-4: Internal Target Capital Ratio for Insurance Companies.*

This document provides background information and analysis that supports FICOM's intention to adopt the guidelines.

BACKGROUND

OSFI recently issued draft guidance regarding internal oversight and risk management assessments for capital and solvency, known as ORSA. This draft guidance complements OSFI's revised draft guidance on internal target capital (ITC).

ITCs form an important part of an insurer's risk management program as they establish a capital target that an insurer uses to manage capital and solvency risks. Having an internal target capital set at a sufficient level above the regulatory capital requirements provides the insurer with a buffer so it can absorb unexpected financial shocks and still remain viable. ITCs act as a trigger that allows the insurer to take its own corrective action before capital erodes to regulatory minimums or levels where FICOM becomes involved. Each insurer is expected to establish its own ITC appropriate to its circumstances, factoring in its risk profile, risk tolerance and operating environment. When determining the target, insurers need to conduct stress testing to identify and quantify events that might plausibly adversely impact their business.

For more information, see OSFI *Guideline E-18: Stress Testing* which FICOM adopted in April 2011.

Regulators (including FICOM and OSFI) consider ORSA, ITCs and stress testing key components of an insurer's overall risk management program.

ISSUES

Understanding and managing inherent risks is a critical responsibility of an insurer.

An insurer is expected to have adequate systems and processes in place to identify and assess material risks, and to assess the quality of the management controls that are used to mitigate those risks which includes capital and solvency risk.

Having adequate capital is critical for the overall safety and stability of an insurer.

FICOM believes that an insurer is at risk of failing unless its risk management program:

- properly assess material risks to capital and solvency;
- tests the effectiveness of controls over those risks; and
- permits it time to take corrective action before its financial situation becomes distressed.

ORSA was developed to provide insurers with explicit guidance to conduct internal risk assessments regarding threats to capital and solvency, with ITCs used as a risk management tool to assist the insurer in managing those risks.

ORSA and ITC guidance are important components in enhancing an insurer's overall risk management program which is a cornerstone of FICOM's Supervisory Framework for all provincially regulated financial institutions.

OBJECTIVES

FICOM intends to adopt the federal ORSA guidance as it will address the following objectives:

- ensure that insurers are self-assessing their internal capital position and ensuring it is adequate and is likely to remain so in the future;
- enhance the insurer's ability to evaluate their risk profile and capital needs and ensure those processes are implemented as sound business practices;
- set national and international developments and standards, including advancements in risk and capital management techniques; and
- support FICOM's Supervisory Framework.

FICOM is considering adopting the federal ITC guidance as it will:

- ensure that insurers are managing their risks to capital and solvency through setting of internal capital positions that provide them with buffers for financial shocks;

- ensure that boards and senior management of insurers have time to take corrective action to address financial shocks and adverse events;
- implement national and international developments and standards, including advancements in risk and capital management techniques; and
- support FICOM's Supervisory Framework.

OPTIONS AND ASSESSMENT

Option 1: Adopt OSFI's Guidelines on ORSA and ITCs

This option is consistent with FICOM's overall regulatory approach that is based on a framework similar to the one used by OSFI. FICOM considers the application of guidance set by OSFI, as well as those set by international bodies like the International Association of Insurance Supervisors, and looks to that guidance as national and international best practices for supervision. Adopting these standards provides consistency in regulatory approaches between OSFI regulated insurers and all BC incorporated insurers.

Option 2: Develop FICOM-Specific Guidance

This option would have FICOM develop its own unique guidance on ORSA and ITCs.

While FICOM is prepared to draft original guidance to the system, it is often appropriate to take existing federal guidelines and repurpose them for provincial use. This ensures clarity and consistency across the two jurisdictions. The OSFI guidelines on ORSA and ITC are equally applicable in a provincial framework and BC insurers would benefit from the harmonized regulatory approach.

Option 3: Do Not Adopt Guidelines

This option would retain the status quo for BC incorporated insurers. FICOM would not adopt either guideline and would rely on existing supervisory practices to ensure the safety and stability of insurers.

FICOM believes that an insurer's board of directors and senior management are responsible for the management of the company and are ultimately accountable for its safety and stability. FICOM also looks to the Board and senior management to be proactive in assessing risks to the company and actively take steps to mitigate or address those risks. The need for an insurer to have adequate capital is critical and FICOM views these guidelines as prudent measures for insurers to take to protect capital.

RECOMMENDATION

FICOM recommends that it pursue Option 1: Adopt OSFI's Guidelines on ORSA and ITCs.

CONSULTATION

FICOM is seeking comments from BC incorporated insurers on the two OSFI draft guidelines by July 31, 2013. FICOM will review all comments, as well as any revisions OSFI makes to the draft guidelines as a result of its own consultations, to determine if any additional amendments need to be made before adoption.

IMPLEMENTATION

If adopted, the two guidelines will be implemented and become effective January 1, 2014. FICOM will issue communication to the system regarding the implementation process once the guideline is released in final form.